

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: INTERSTATE POWER AND LIGHT COMPANY	DOCKET NO. RPU-02-7
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ORDER DENYING REHEARING

(Issued July 1, 2003)

On May 15, 2003, the Utilities Board (Board) issued a “Final Decision and Order” in Docket No. RPU-02-7 granting a permanent gas rate increase to Interstate Power and Light Company (IPL). On May 28, 2003, the Board issued an order granting IPL a stay of Ordering Clauses No. 2 and No. 3 of the May 15, 2003, order until the Board has issued an order addressing IPL’s application for rehearing. Ordering Clause No. 2 required IPL to file a revised cost allocation study, revised class cost-of-service study, and revised tariffs on or before May 30, 2003. Ordering Clause No. 3 required IPL to file a refund plan on or before May 30, 2003.

On June 4, 2003, IPL filed an application for rehearing of three issues from the Board’s May 15, 2003, order. The issues are identified as “MICP/EICP Awards,” “Traditional Double Leverage,” and “Plant Annualization Adjustment.” On June 18, 2003, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed an answer requesting the Board deny the application for rehearing.

The three issues raised by IPL in the application for rehearing are addressed below.

1. MICP/EICP AWARDS

This issue involves IPL's Management Incentive Compensation Plan (MICP) and Employee Incentive Compensation Plan (EICP). In the May 15, 2003, order the Board determined that no costs associated with the compensation plans should be included in rates. IPL contends that the Board ignored the fact that the record showed that incentive payments were made relating to the financial results associated with the 2001 test year and the Board should examine the record that indicates that incentive payments were made from 1999-2001. IPL asserts that the resolution of this issue is inconsistent with the Board's findings regarding IPL's capital structure, where the Board rejected proposed changes regardless of whether the changes had been implemented.

IPL also argues that to deny any recovery of incentive plan payments is unreasonable and restates its argument from its initial brief: "It is irrational to suggest that the Company should be denied recovery for test year incentive compensation because it failed to earn its authorized rate of return a year later. Such a position clearly violates the matching principle."

Consumer Advocate contends that it would be incorrect to include costs, such as the incentive plan payments, that a utility was not going to incur. Consumer

Advocate argues the Board should deny rehearing on incentive compensation for the same reasons as it did in the electric case.

The Board has considered the arguments made by IPL on rehearing and finds that these arguments are the same as those considered in the original decision. The Board finds that the record evidence still shows that IPL did not make incentive payments for the year 2002 and it would be unreasonable to include amounts in rates for an incentive program where no payments were made. The Board will deny rehearing on this issue.

2. TRADITIONAL DOUBLE LEVERAGE

A. \$24 Million Debt Issue

This issue involves whether \$24 million of debt issued by the predecessor of IPL's parent, Alliant Energy Corporation (AEC), should be used in the double leverage calculation. IPL argues that the debt was not used at any time to support the equity of IPL. IPL contends that the Board ignored the key evidence that it is impossible for the proceeds from the debt issued by AEC's predecessor in 1994 to have been injected into IPL's common equity in September 2002. The arguments made by IPL on this issue are similar to the arguments made by IPL in the application for rehearing filed in its electric rate case, Docket Nos. RPU-02-3 and RPU-02-8.

Consumer Advocate states the Board should deny rehearing on this issue for the same reasons as in the electric case.

In its May 15, 2003, order, the Board considered the arguments made by IPL with regard to the \$24 million debt issue and the double leverage methodology. The Board also considered its arguments in the rehearing of the electric rate case. The Board denied rehearing in the electric rate case based upon arguments similar to those made in this case. The arguments made in this docket raise the same issues with the Board's decision.

The Board considered the evidence concerning the use of the \$24 million debt issue based upon the four criteria found in Iowa Electric Light and Power Company, Docket Nos. RPU-89-3 and RPU-89-9, for disproving the reasonableness of double leverage. The evidence in this case shows that IPL did not satisfy the fourth factor, which requires that the only increase to common equity since inception had been through an increase in the utility's retained earnings. The evidence in this case showed that AEC had infused capital into IPL and thus double leverage was appropriate. In addition, the Board noted in denying rehearing in the electric case that capital is fungible, which is the basis for the double leverage adjustment. That principle is equally applicable to this case. The Board will deny rehearing on this issue.

B. Return on Equity

IPL argues that the return on equity established by the Board was unrelated to AEC and should not be used in the Board's traditional double leverage calculation.

IPL contends the application of double leverage makes an investment in IPL less attractive than other, similarly-situated companies.

Consumer Advocate states that the Board should deny rehearing on this issue for the same reasons as in the electric case.

The Board has considered IPL's arguments concerning the return on equity (ROE) of 11.05 percent found by the Board to be reasonable for IPL gas operations. In arriving at the ROE, the Board considered the estimates of ROE's produced by those models it considered to be reliable. The Board considered the estimates of certain models using AEC as a proxy, but did not consider the Discounted Cash Flow (DCF) models using AEC as a proxy because of "recent financial volatility, the changing views of the rating agencies, and the widely divergent results."

The Board found the reliable estimates in this record supported a lower ROE than did the evidence in the electric proceeding. The Board also determined that the 11.05 percent ROE found reasonable for interim rates in this docket was reasonable for permanent rates even though the most recent A-rated bond rating indicated the ROE could be lower.

The Board will not grant rehearing on the return on equity used in the double leverage calculation. As stated in the May 15, 2003, order, "determining the appropriate return on equity is not an exact science and other persons looking at this record might reach a different conclusion. However, the return selected is well within the zone of reasonableness, based upon the evidence presented."

3. PLANT ANNUALIZATION ADJUSTMENT

The issue involves IPL's proposed pro forma adjustment to rate base to reflect annualized year-end plant in service. The Board did not adopt the proposed adjustment. IPL cites several Board decisions where the Board adopted year-end adjustments in support of its request for rehearing. IPL also points out that the Board allowed adjustments for major plant additions in the IPL electric rate case after it determined the additions were completed and providing service to customers.

IPL states that while the Board's order suggests that the use of year-end rate base raises matching issues that IPL had not adequately addressed, there has been no suggestion that any other components of costs savings or income can be "qualified," other than those submitted by IPL as a part of its proposed adjustment. IPL contends that in rejecting IPL's proposed plant annualization adjustment, the Board has failed to consider the fact that safety is imperative in the gas distribution business and that the operation and replacement of gas distribution systems is highly regulated.

Consumer Advocate argues that the Board's rejection of IPL's proposed year-end rate base is perfectly consistent with precedent and IPL does not offer a single example of a final decision in a contested case in which the Board approved the use of a year-end rate base to determine a revenue requirement and final rates for regulated utility services.

The Board has considered the arguments concerning this issue and is not persuaded that the matching issues that would be raised by adopting a year-end rate base have been adequately addressed by IPL. Adoption of IPL's proposal would be a dramatic change in Board precedent and the evidence in this case does not support making that change. The Board will deny rehearing on this issue.

IT IS THEREFORE ORDERED:

1. The application for rehearing filed by Interstate Power and Light Company on June 4, 2003, is denied.
2. The stay of Ordering Clauses No. 2 and No. 3 of the May 15, 2003, "Final Decision and Order" is lifted.
3. Interstate Power and Light Company shall comply with the May 15, 2003, order within 15 days of the date of this order.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

**CONCURRING OPINION OF ELLIOTT G. SMITH
DOCKET NO. RPU-02-7**

I would grant rehearing on the Plant Annualization Adjustment issue. As I stated in my concurring opinion in the final order, I believe that the methodology used by IPL effectively annualized all additions, retirements, and revenue for the calendar

year and IPL demonstrated that a year-end rate base, when properly calculated, annualizes all elements of rate base added or retired from rate base throughout a year.

ATTEST: /s/ Elliott Smith

/s/ Judi K. Cooper
Executive Secretary

Dated at Des Moines, Iowa, this 1st day of July, 2003.